COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF THE WATERFERN-FERN CREEK GARDENS SEWER CONSTRUCTION DISTRICT OF JEFFERSON COUNTY, KENTUCKY	))))	CASE NO. 8380

O R D E R

PROCEDURAL BACKGROUND

On November 12, 1981, the Waterfern-Fern Creek Gardens Sewer Construction District ("Waterfern") filed an application with the Commission seeking approval of an increase in sewer service rates presently being charged its customers. The proposed rates would produce an increase in gross annual revenues of approximately $76,200 or 76.6 percent above test period revenues. The Commission in this order has allowed Waterfern rates to produce an increase in revenue of $50,621.

A public hearing was held in this matter on February 11, 1982, in the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Attorney General's office was permitted to intervene. Further, the Commission allowed Ms. Barbara Nelson, Ms. Amanda Martin, Mr. Steve Badgett and Mr. Larry Schwendeman, customers of Waterfern, to make statements in the record of evidence.

All additional information requested at the hearing has been filed, and the entire matter is now submitted for final determination by the Commission.

COMMENTARY

The majority of the increase in rates sought by Waterfern is to provide monies to replace items of essential equipment to meet the standards of the Jefferson County Board of Health and to repay past due liabilities including judgment damages. Ordinarily, the Commission would not provide rates sufficient to meet the above requirements currently. The Commission would ordinarily provide rates sufficient to meet current obligations and to improve the financial stability of a utility so that it could seek long-term financing from a financial institution, thus spreading the cost to the ratepayers over a number of years. Were Waterfern an investor-owned utility the Commission would require the stockholders to bear the cost of judgments caused by poor management practices. Since Waterfern is a district, the Commission has no alternative but to require payment from the ratepayers. Moreover, the financial position of Waterfern is so seriously deficient that it has been unable to secure any financing from financial institutions. Assuming that it could obtain a loan pursuant to the issuance of this order, it is likely that a lending institution would require such high interest rates that the cost to the ratepayers would ultimately be greater than the cost under the rate plan outlined herein.

Waterfern's present financial and operational problems resulted from inappropriate management practices by its former commissioners. Waterfern is now under new management, and it appears to this Commission that these newly appointed commissioners are making a concerted effort to improve both its financial and service operations. In the remaining pages of this order, the Commission will explain the basis for the rates granted herein and the procedures which will permit Waterfern under good management to achieve a solvent financial position while maintaining good service to its customers.

ANALYSIS AND DETERMINATION

Test Period

Waterfern proposed and the Commission has accepted the 12-month period ending August 31, 1981, as the test period in this matter.

Valuation Method

Pursuant to the testimony by Mr. Bill Reichart, Waterfern's Chairman,[1/] and Mr. David R. Buchenberger, Certified Public Accountant,[2/] who prepared the accounting exhibits

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1/ Transcript of Evidence, February 11, 1982, page 62.

2/ Transcript of Evidence, February 11, 1982, page 40.

in this case, the Commission finds that since Waterfern's accounting records prior to 1979 have been misplaced there is not information sufficient to determine Waterfern's net investment rate base or capitalization for rate-making purposes. Furthermore, Waterfern has been in operation since 1963 and has no long-term debt currently outstanding, thus eliminating the calculation of rates by a debt service method. Moreover, Waterfern proposed no specific valuation method in its application. Therefore, the Commission is of the opinion that the "Operating Ratio Method" should be used in this instance.

The formula used in computing operating ratio is as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

Revenues and Expenses

Waterfern proposed several pro forma adjustments to actual operating revenues and expenses for the 12 months ended August 31, 1981.[3/] The Commission finds these adjustments proper and has accepted them for rate-making purposes with the following exceptions:

Repairs and Maintenance

As discussed previously, Waterfern proposed an adjustment

3/ Exhibit No. 13 - Comparative Income Statement.

of $35,889 to test year expenses for the purpose of making capital improvements to its sewer system as required by the Jefferson County Board of Health. The Commission is of the opinion that this cost should more appropriately be amortized over a 4-year period at $8,972 per year and collected through a special surcharge to its customers.

Amortization of Liabilities

Waterfern has incurred the following debts due to inappropriate management and insufficient funds to meet its obligations:

Plant Operations	$ 9,116
Legal and Accounting	16,068
Legal Judgments	83,836
Total	$109,020

Waterfern proposed to amortize these delinquent obligations over a 3- to 5-year period by including an annual charge of $25,162 in its pro forma operating expenses to be collected through its basic rate. After an examination of the record in this case, the Commission finds that payments of $12,524[4] have been applied to these obligations, leaving an unpaid balance of $96,497. The Commission finds it appropriate to amortize this cost over a 4-year period, at $24,124 per year, again to be collected through a special surcharge to its customers.

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[4] Transcript of Evidence, February 11, 1982, pages 54 and 85.

Depreciation Expense

The Commission has denied any allowance for pro forma depreciation expense on the proposed construction expenditures of $35,889. The customers of Waterfern will be paying for this construction through the monthly surcharge included in the sewer bill.

Agency Collection Fee

Waterfern projected expenses related to the collection of its bi-monthly sewer bill by the Louisville Water Company of $1,971. The Commission has made an adjustment of $512[5] to increase this expense to reflect the apportionment of the joint service cost of the collection agency for each bi-monthly bill of the customer which includes the charge for both water and sewer service.

Therefore, Waterfern's adjusted operations at the end of the test period are as follows:

	Actual	Adjustments	Adjusted
Operating Revenues	$ 43,159	$ -0-	$ 43,159
Operating Expenses	82,603	(3,655)	78,948
Net Operating Income	$(39,444)	$ 3,655	$(35,789)
Interest Expense	2,621	1,433	4,054
Net Income	$(42,065)	$ 2,222	$(39,843)

5/ $1.53 x 337 x 6 x 80.27% = $2,483 - $1,971 = $512.

Revenue Requirements

The Commission is of the opinion that Waterfern's adjusted operating loss is unfair, unjust and unreasonable. The Commission is further of the opinion that Waterfern should be permitted to earn a fair, just and reasonable operating ratio of 88 percent. Therefore, the Commission finds that Waterfern is entitled to increase its rates to produce an increase in annual revenue of $50,621.[6/]

Moreover, the Commission, after a review of the adjusted revenues and expenses of Waterfern, has determined that the most equitable method of reaching a fair and just rate for its customers would be to apply a surcharge for a period of 4 years. The surcharge would provide an accumulation of funds for capital expenditures of $35,889 and the elimination of delinquent debts of approximately $96,400. The remaining funds obtained through the basic sewer rate would enable Waterfern to pay its operating expenses and interest cost and have a reasonable surplus remaining.

Therefore, the Commission concludes that Waterfern is entitled to increase its rates to produce gross annual operating revenues of $93,780 to be derived from the following rate methods:

Monthly Surcharge:	$ 8.19 x 337 customers x 12 months =	$33,120
Basic Monthly Rate:	$15.00 x 337 customers x 12 months =	60,660
Total		$93,780

6/ $78,959 ÷ 88% = $89,726 + $4,054 = $93,780 - $43,159 = $50,621.

Moreover, prudent management of the financial affairs of Waterfern by the present commissioners should enable it to regain a reasonable credit rating with lending institutions.

FINDINGS AND ORDER

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The determination of rates and charges of Waterfern should be based on the operating ratio method.

2. An operating ratio of 88 percent results from test-year operations, as adjusted, and is the fair, just and reasonable operating ratio in that it will allow Waterfern to pay its operating expenses, meet its credit requirements and provide a reasonable surplus.

3. The rates and charges in Appendix A should produce gross annual revenues of approximately $93,780 from 337 customers and are the fair, just and reasonable rates and charges for sewer service rendered by Waterfern to customers located in the Waterfern-Fern Creek Gardens Subdivision, Jefferson County, Kentucky.

4. The rates and charges proposed by Waterfern would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

5. Waterfern should be required to establish a special interest-bearing account, for the purpose of accumulating annual funds of $33,120 to retire its delinquent obligations and make

certain improvements and repairs to the sewer system as required by the Jefferson County Board of Health.

6. Waterfern should be required to submit a quarterly report to the Commission setting out the following information:

a. Monthly deposits of $2,760 to the account;

b. Interest earnings credited to the account;

c. All disbursements from the account and the recipients thereof.

7. Waterfern should make a concerted effort to purchase the 1-1/4 acre land site for the proposed tertiary lagoon at a reasonable cost rather than continue the lease arrangement with Mr. Thomas J. Medley, whereby Waterfern would be required to make annual lease payments totalling approximately $81,000 over 25 years.

IT IS THEREFORE ORDERED that the rates in Appendix A are hereby fixed as the fair, just and reasonable rates of the Waterfern-Fern Creek Gardens Sewer Construction District to become effective for sewer service rendered on and after the date of this order.

IT IS FURTHER ORDERED that the rates and charges proposed by Waterfern would produce revenues in excess of those found reasonable herein and are hereby denied upon application of KRS 278.030.

IT IS FURTHER ORDERED that Waterfern shall establish a special interest-bearing account and make monthly deposits of

$2,760 thereto, the reporting requirements being the same as set out in findings 5 and 6.

IT IS FURTHER ORDERED that within 20 days of the date of this order, Waterfern shall file with this Commission its tariff sheets setting forth the rates and charges approved herein. Further, a copy of Waterfern's rules and regulations for providing sewer service to its customers shall be filed with the tariff sheets.

Done at Frankfort, Kentucky, this 7th day of April, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

Denni Carrigan
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8380 DATED APRIL 7, 1982

The following rates are prescribed for all customers served by Waterfern Fern Creek Gardens Sewer Construction District, located in Jefferson County, Kentucky:

RATES: Monthly

Customer Category	
Single Family Residential	$ 15.00 per residence
Commercial	15.00 per residential equivalent
All other	15.00 per residential equivalent

*There shall be a monthly surcharge of $8.19 per residence for a period of 4 years beginning on and after the date of this order.